# EXHIBIT V

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

## FORM 10-K

(Mark One)

☑ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 29, 2006

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 1-7182

# Merrill Lynch & Co., Inc.
**(Exact name of Registrant as specified in its charter)**

| | |
|---|---|
| **Delaware**<br>**(State or other jurisdiction of incorporation or organization)** | **13-2740599**<br>**(I.R.S. Employer Identification No.)** |
| **4 World Financial Center, New York, New York**<br>**(Address of principal executive offices)** | **10080**<br>**(Zip Code)** |

**Registrant's telephone number, including area code: (212) 449-1000**

**Securities registered pursuant to Section 12(b) of the Act:**

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|---|
| Common Stock, par value $1.33⅓ and attached Rights to Purchase Series A Junior Preferred Stock | New York Stock Exchange<br>Chicago Stock Exchange |
| Depositary Shares representing 1/1200th share of Floating Rate Non-Cumulative Preferred Stock, Series 1; Depositary Shares representing 1/1200th share of Floating Rate Non-Cumulative Preferred Stock, Series 2; Depositary Shares representing 1/1200th share of 6.375% Non- Cumulative Preferred Stock, Series 3; Depositary Shares representing 1/1200th share of Floating Rate Non-Cumulative Preferred Stock, Series 4; and S&P 500® Inflation Adjusted MITTS® Securities due September 24, 2007; Trust Preferred Securities of Merrill Lynch Capital Trust I (and the guarantees with respect thereto) | New York Stock Exchange |

See the full list of securities listed on the American Stock Exchange and The NASDAQ Stock Market on the pages directly following this cover.

**Securities registered pursuant to Section 12(g) of the Act:**
**None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☑ No ☐

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☑

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☑

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

As of the close of business on June 30, 2006, the aggregate market value of the voting stock, comprising the Common Stock and the Exchangeable Shares, held by non-affiliates of the Registrant was approximately $62.1 billion.

As of the close of business on February 16, 2007, there were 881,700,999 shares of Common Stock and 2,634,716 Exchangeable Shares outstanding. The Exchangeable Shares, which were issued by Merrill Lynch & Co., Canada Ltd. in connection with the merger with Midland Walwyn Inc., are exchangeable at any time into Common Stock on a one-for-one basis and entitle holders to dividend, voting and other rights equivalent to Common Stock.

**Documents Incorporated By Reference:** Portions of the Merrill Lynch Proxy Statement to be filed for its 2007 Annual Meeting of Shareholders to be held April 27, 2007 are incorporated by reference in this Form 10-K in response to Part III.

Pages 1 through 18, on which appeared a portion of Merrill Lynch & Co., Inc.'s 2006 Annual Report to Shareholders, are not filed with, incorporated by reference in or otherwise to be deemed a part of this Annual Report on Form 10-K.

# Selected Financial Data

| (dollars in millions, except per share amounts) | **2006 (52 weeks)** | 2005 (52 weeks) | 2004 (53 weeks) | 2003 (52 weeks) | 2002 (52 weeks) |
|---|---|---|---|---|---|
| | Year Ended Last Friday in December | | | | |
| **Results of Operations** | | | | | |
| Total Revenues | **$ 70,591** | $ 47,796 | $ 32,619 | $ 27,924 | $ 28,361 |
| Less Interest Expense | **35,932** | 21,774 | 10,560 | 8,024 | 9,990 |
| Net Revenues | **34,659** | 26,022 | 22,059 | 19,900 | 18,371 |
| Non-Interest Expenses | **24,233** | 18,791 | 16,223 | 14,680 | 16,059 |
| Earnings Before Income Taxes | **10,426** | 7,231 | 5,836 | 5,220 | 2,312 |
| Income Tax Expense | **2,927** | 2,115 | 1,400 | 1,384 | 604 |
| Net Earnings | **$ 7,499** | $ 5,116 | $ 4,436 | $ 3,836 | $ 1,708 |
| Net Earnings Applicable to Common Stockholders[(1)] | **$ 7,311** | $ 5,046 | $ 4,395 | $ 3,797 | $ 1,670 |
| **Financial Position** | | | | | |
| Total Assets | **$ 841,299** | $ 681,015 | $ 628,098 | $ 480,233 | $ 440,252 |
| Short-Term Borrowings[(2)] | **284,226** | 221,389 | 180,058 | 111,727 | 98,371 |
| Deposits | **84,124** | 80,016 | 79,746 | 79,457 | 81,842 |
| Long-Term Borrowings | **181,400** | 132,409 | 119,513 | 85,178 | 79,788 |
| Junior Subordinated Notes (related to trust preferred securities) | **3,813** | 3,092 | 3,092 | 3,203 | 3,188 |
| Total Stockholders' Equity | **39,038** | 35,600 | 31,370 | 28,884 | 24,081 |
| **Common Share Data** | | | | | |
| (in thousands, except per share amounts) | | | | | |
| Earnings Per Share: | | | | | |
| Basic | **$ 8.42** | $ 5.66 | $ 4.81 | $ 4.22 | $ 1.94 |
| Diluted | **$ 7.59** | $ 5.16 | $ 4.38 | $ 3.87 | $ 1.77 |
| Weighted-Average Shares Outstanding: | | | | | |
| Basic | **868,095** | 890,744 | 912,935 | 900,711 | 862,318 |
| Diluted | **962,962** | 977,736 | 1,003,779 | 980,947 | 947,282 |
| Shares Outstanding at Year-End | **867,972** | 919,201 | 931,826 | 949,907 | 873,780 |
| Book Value Per Share | **$ 41.35** | $ 35.82 | $ 32.99 | $ 29.96 | $ 27.07 |
| Dividends Paid Per Share | **$ 1.00** | $ 0.76 | $ 0.64 | $ 0.64 | $ 0.64 |
| **Financial Ratios** | | | | | |
| Pre-Tax Profit Margin | **30.1%** | 27.8% | 26.5% | 26.2% | 12.6% |
| Common Dividend Payout Ratio | **11.9%** | 13.4% | 13.3% | 15.2% | 33.0% |
| Return on Average Assets | **0.9%** | 0.7% | 0.8% | 0.8% | 0.4% |
| Return on Average Common Stockholders' Equity | **21.3%** | 16.0% | 14.9% | 14.8% | 7.5% |
| **Other Statistics** | | | | | |
| Full-Time Employees: | | | | | |
| U.S. | **43,700** | 43,200 | 40,200 | 38,200 | 40,000 |
| Non-U.S. | **12,500** | 11,400 | 10,400 | 9,900 | 10,900 |
| Total[(3)] | **56,200** | 54,600 | 50,600 | 48,100 | 50,900 |
| Private Client Financial Advisors | **15,880** | 15,160 | 14,140 | 13,530 | 14,010 |
| Private Client Assets (dollars in billions) | **$ 1,619** | $ 1,458 | $ 1,359 | $ 1,267 | $ 1,098 |

(1) Net earnings less preferred stock dividends.

(2) Consists of payables under repurchase agreements and securities loaned transactions and short-term borrowings.

(3) Excludes 100, 200, 100, 200, and 1,500 full-time employees on salary continuation severance at year-end 2006, 2005, 2004, 2003 and 2002, respectively.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Forward-Looking Statements and Non-GAAP Financial Measures

Certain statements in this report may be considered forward-looking, including those about management expectations, strategic objectives, growth opportunities, business prospects, anticipated financial results, the impact of off-balance sheet arrangements, significant contractual obligations, anticipated results of litigation and regulatory investigations and proceedings, and other similar matters. These forward-looking statements represent only Merrill Lynch & Co., Inc.'s ("ML & Co." and, together with its subsidiaries, "Merrill Lynch", "we", "our" or "us") beliefs regarding future performance, which is inherently uncertain. There are a variety of factors, many of which are beyond our control, which affect our operations, performance, business strategy and results and could cause our actual results and experience to differ materially from the expectations and objectives expressed in any forward-looking statements. These factors include, but are not limited to, actions and initiatives taken by both current and potential competitors, general economic conditions, the effects of current, pending and future legislation, regulation and regulatory actions, and the other risks and uncertainties detailed in this report. See "Risk Factors that Could Affect Our Business". Accordingly, readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the dates on which they are made. We do not undertake to update forward-looking statements to reflect the impact of circumstances or events that arise after the dates they are made. You should, however, consult further disclosures we make in future filings of our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K.

From time to time, we may also disclose financial information on a non-GAAP basis where management uses this information and believes this information will be valuable to investors in gauging the quality of Merrill Lynch's financial performance, identifying trends in our results and providing more meaningful period-to-period comparisons. For a reconciliation of non-GAAP measures presented throughout our Annual Report see Exhibit 99.1 filed with the 2006 Form 10-K.

## Available Information

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"). You may read and copy any document we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for information on the Public Reference Room. The SEC maintains an internet site that contains annual, quarterly and current reports, proxy and information statements and other information that we file electronically with the SEC. The SEC's internet site is www.sec.gov.

Our internet address is www.ml.com, and the investor relations section of our website can be accessed directly at www.ir.ml.com. We make available, free of charge, our proxy statements, Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. These reports are available through our website as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the SEC. We have also posted on our website corporate governance materials including our Guidelines for Business Conduct, Code of Ethics for Financial Professionals, Director Independence Standards, Corporate Governance Guidelines, Related Party Transactions Policy and charters for the committees of our Board of Directors. In addition, our website includes information on purchases and sales of our equity securities by our executive officers and directors, as well as disclosures relating to certain non-GAAP financial measures (as defined in the SEC's Regulation G) that we may make public orally, telephonically, by webcast, by broadcast or by similar means from time to time.

We will post on our website amendments to our Guidelines for Business Conduct and Code of Ethics for Financial Professionals and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange. The information on our website is not incorporated by reference into this Report. You can obtain printed copies of these documents, free of charge, upon written request to Judith A. Witterschein, Corporate Secretary, Merrill Lynch & Co., Inc., 222 Broadway, 17th Floor, New York, NY 10038 or by email at corporate_secretary@ml.com.

## Overview

Merrill Lynch was formed in 1914 and became a publicly traded company on June 23, 1971. In 1973, we created the holding company, ML & Co., a Delaware corporation that, through its subsidiaries, is one of the world's leading wealth management, capital markets and advisory companies with offices in 37 countries and territories and total client assets of approximately $1.6 trillion at December 29, 2006. As an investment bank, we are a leading global trader and underwriter of securities and derivatives across a broad range of asset classes, and we serve as a strategic advisor to corporations, governments, institutions and individuals worldwide. In addition, we own a 45% voting interest and approximately half of the economic interest of BlackRock, Inc. ("BlackRock"), one of the world's largest publicly traded investment management companies with approximately $1.1 trillion in assets under management at December 31, 2006.

We conduct our business from various locations throughout the world. Our world headquarters is located in the World Financial Center in New York City, and our other principal United States business and operational centers are located in New Jersey and Florida. Our major geographic regions of operations include the United States; Europe, the Middle East and Africa ("EMEA"); the Pacific Rim; Canada; and Latin America.

Since the fourth quarter of 2006, our business segment reporting reflects the management reporting lines established after the merger of our Merrill Lynch Investment Managers ("MLIM") business with BlackRock on September 29, 2006 (the "BlackRock merger"), as well as the economic and long-term financial performance characteristics of the underlying businesses.

Prior to the fourth quarter of 2006, we reported our business activities in three operating segments: Global Markets and Investment Banking ("GMI"), Global Private Client ("GPC"), and MLIM. Effective with the BlackRock merger, MLIM ceased to exist as a separate business segment. Accordingly, a new business segment, Global Wealth Management ("GWM"), was created, consisting of GPC and Global Investment Management ("GIM"). GWM along with GMI will now be our business segments. We have restated prior period segment information to conform to the current period presentation and, as a result, are presenting GWM as if it had existed for these prior periods. See Note 3 to the Consolidated Financial Statements for further information on segments.

The BlackRock merger closed on the last day of our third fiscal quarter, and as a result, our 2006 results of operations for MLIM include only results through the first nine months of 2006. For more information on the BlackRock merger, refer to Note 2 to the Consolidated Financial Statements.

The following is a description of our business segments, including MLIM, which ceased to exist as a separate business segment effective with the BlackRock merger:

- *GMI,* our institutional business segment, provides trading, capital markets services, investment banking and advisory services to corporations, financial institutions, institutional investors, and governments around the world. GMI's Global Markets division facilitates client transactions and is a market maker in securities, derivatives, currencies, commodities and other financial instruments to satisfy client demands. In addition, GMI also engages in certain proprietary trading activities. Global Markets also provides clients with financing, securities clearing, settlement, and custody services and also engages in principal and private equity investing. GMI's Investment Banking division provides a wide range of securities origination and strategic advisory services for issuer clients, including underwriting and placement of public and private equity, debt and related securities, as well as lending and other financing activities for clients globally. These services also include advising clients on strategic issues, valuation, mergers, acquisitions and restructurings. In 2006, GMI generated 57% of our net revenues and 65% of our pre-tax earnings. GMI's growth strategy entails a program of investments in personnel and technology to gain further scale in certain asset classes and geographies.
- *GWM,* our full-service retail wealth management segment, provides brokerage, investment advisory and financial planning services, offering a broad range of both proprietary and third-party wealth management products and services globally to individuals, small- to mid-size businesses, and employee benefit plans. Within the GPC division, most of our services are delivered by our Financial Advisors ("FAs") through a global network of branch offices. GPC's offerings include commission and fee-based investment accounts; banking, cash management, and credit services, including consumer and small business lending and Visa® cards; trust and generational planning; retirement services; and insurance products. GWM's GIM division includes a business that creates and manages hedge fund and other alternative investment products for GPC clients, and Merrill Lynch's share of net earnings from its ownership positions in other investment management companies, including our investment in BlackRock. In 2006, GWM generated 37% of our net revenues and 28% of our pre-tax earnings. GWM's growth priorities include continued growth in client assets, the hiring of additional FAs, client segmentation, annuitization of revenues through fee-based products, diversification of revenues through adding products and services, investments in technology to enhance productivity and efficiency, and disciplined expansion into additional geographic areas globally.
- *MLIM,* our asset management segment through the third quarter of 2006 and prior to the BlackRock merger, offered a wide range of investment management capabilities to retail and institutional investors through proprietary and third-party distribution channels globally. Asset management capabilities included equity, fixed income, money market, index, enhanced index and alternative investments, which were offered through vehicles such as mutual funds, privately managed accounts, and retail and institutional separate accounts. In 2006, MLIM generated 6% of our net revenues and 7% of our pre-tax earnings, which reflects its results only for the first nine months of 2006 prior to the BlackRock merger.

We also provide a variety of research services on a global basis through our Global Securities Research & Economics Group. These services are at the core of the value proposition we offer to institutional and individual client sales forces and their customers, and are an integral component of the product offering to GMI and GWM clients. This group distributes research focusing on four main disciplines globally: fundamental equity research, fixed income and equity-linked research, economics and foreign exchange research and investment strategy research. We consistently rank among the leading research providers in the industry, and our analysts and other professionals cover approximately 3,000 companies.

We are a Consolidated Supervised Entity ("CSE") and subject to group-wide supervision by the SEC. As a CSE, we compute our allowable capital and allowances and permit the SEC to examine the books and records of the holding company and any subsidiary that does not have a principal regulator; and we have adopted various additional SEC reporting, record-keeping, and notification requirements. We are in compliance with applicable CSE standards. Being a CSE has imposed additional costs, although not material to date, and has introduced new requirements to monitor capital adequacy. In respect of the European Union ("EU") Financial Conglomerates (or "Financial Groups") Directive, the U.K. Financial Services Authority ("FSA") has determined that the SEC undertakes equivalent consolidated supervision for Merrill Lynch.

## Risk Factors that Could Affect Our Business

In the course of conducting our business operations, we could be exposed to a variety of risks that are inherent to the financial services business. A summary of some of the significant risks that could affect our financial condition and results of operations is included below. Some of these risks are managed in accordance with established risk management policies and procedures, most of which are described in the Risk Management section of the Management's Discussion and Analysis.

### Market Risk

**Our business may be adversely impacted by global market and economic conditions that may cause fluctuations in interest rates, exchange rates, equity and commodity prices and credit spreads.** We are exposed to potential changes in the value of financial instruments caused by fluctuations in interest rates, exchange rates, equity and commodity prices, credit spreads, and/or other risks. These fluctuations may result from changes in economic conditions, monetary and fiscal policies, the liquidity of global markets, availability and cost of capital, international and regional political events, acts of war or terrorism and investor sentiment. We have a large and increasing amount of proprietary trading and investment positions, which include proprietary trading positions in fixed income, currency, commodities and equity securities, as well as in real estate, private equity and other investments. We may incur losses as a result of increased market volatility, as these fluctuations may adversely impact the valuation of our trading and investment positions. Conversely, a decline in volatility may adversely affect the results in our trading business, which depend on market volatility to create client and proprietary trading opportunities.

### Credit Risk

**Our business may be adversely impacted by an increase in our credit exposure related to trading, lending, and other business activities.** We are exposed to the potential for credit-related losses that can occur as a result of an individual, counterparty or issuer being unable or unwilling to honor its contractual obligations. These credit exposures exist within lending relationships, commitments, letters of credit, derivatives, foreign exchange and other transactions. These exposures may arise, for example, from a decline in the financial condition of a counterparty, from entering into swap or other derivative contracts under which counterparties have obligations to make payments to us, from a decrease in the value of securities of third parties that we hold as collateral, or from extending credit to clients through loans or other arrangements. As our credit exposure increases, it could have an adverse effect on our business and profitability if material unexpected credit losses occur.

### Liquidity Risk

**Our business and financial condition may be adversely impacted by an inability to borrow funds or sell assets to meet maturing obligations.** We are exposed to liquidity risk, which is the potential inability to repay short-term borrowings with new borrowings or assets that can be quickly converted into cash while meeting other obligations and continuing to operate as a going concern. Our liquidity may be impaired due to circumstances that we may be unable to control, such as general market disruptions or an operational problem that affects our trading clients or ourselves. Our ability to sell assets may also be impaired if other market participants are seeking to sell similar assets at the same time. Our inability to borrow funds or sell assets to meet maturing obligations, a negative change in our credit ratings that would have an adverse effect on our ability to borrow funds, or regulatory capital restrictions imposed on the free flows of funds between us and our subsidiaries may have a negative effect on our business and financial condition.

### Operational Risk

**We may incur losses due to the failure of people, internal processes and systems or from external events.** Our business may be adversely impacted by operational failures or from unfavorable external events. We are exposed to the risk of loss resulting from the failure of people, internal processes and systems or from external events. Such operational risks may include, exposure to theft and fraud, improper business practices, client suitability and servicing risks, product complexity and pricing risk or from improper recording, evaluating or accounting for transactions. We could suffer financial loss, disruption of our business, liability to clients, regulatory intervention or reputational damage from such events, which would affect our business and financial condition.

### Litigation Risk

**Legal proceedings could adversely affect our operating results for a particular period and impact our credit ratings.** We have been named as a defendant in various legal actions, including arbitrations, class actions, and other litigation arising in connection with our activities as a global diversified financial services institution. Some of the legal actions against us include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the issuers who would otherwise be the primary defendants are bankrupt or otherwise in financial distress. Given the number of these matters, some are likely to result in adverse judgments, penalties, injunctions, fines, or other relief. We are also involved in investigations and/or proceedings by governmental and self-regulatory agencies.

We may explore potential settlements before a case is taken through trial because of uncertainty, risks, and costs inherent in the litigation process. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 5, *Accounting for Contingencies*, we will accrue a liability when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. In many lawsuits and arbitrations, including almost all of the class action lawsuits disclosed in "Other Information (Unaudited) — Legal Proceedings", it is not possible to determine whether a liability has been incurred or to estimate the ultimate or minimum amount of that liability until the case is close to resolution, in which case no accrual is made until that time. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases in which claimants seek substantial or indeterminate damages, we cannot predict what the eventual loss or range of loss related to such matters will be. Potential losses may be material to our operating results or cash flows for any particular period and may impact our credit ratings.

### Regulatory and Legislative Risks

**Many of our businesses are highly regulated and could be impacted, and in some instances adversely impacted, by regulatory and legislative initiatives around the world.** Our business may be affected by various U.S. and non-U.S. legislative bodies and regulatory and exchange authorities, such as federal and state securities and bank regulators including the SEC, the FSA, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision ("OTS"), and the Utah Department of Finance Institutions, and self-regulatory organizations including The New York Stock Exchange, Inc. ("NYSE"), the National Association of Securities Dealers, Inc. ("NASD"), the Commodity Futures Trading Commission ("CFTC") and industry participants that continue to review and, in many cases, adopt changes to their established rules and policies. Such changes have occurred in areas such as corporate governance, anti-money laundering, privacy, research analyst conflicts of interest and qualifications, practices related to the issuance of securities, mutual fund trading, disclosure practices and auditor independence.

### Competitive Environment

**Competitive pressures in the financial services industry could adversely affect our business and results of operations.** We compete globally for clients on the basis of price, the range of products that we offer, the quality of our services, our financial resources, and product and service innovation. The financial services industry continues to be affected by an intensifying competitive environment, as demonstrated by the introduction of new technology platforms, consolidation through mergers, increased competition from new and established industry participants and diminishing margins in many mature products and services. We compete with U.S. and non-U.S. commercial banks and other broker-dealers in brokerage, underwriting, trading, financing and advisory businesses. For example, the financial services industry in general, including us, has experienced intense price competition in brokerage, as the ability to execute trades electronically, through the internet and through other alternative trading systems has pressured trading commissions and spreads. Many of our non-U.S. competitors may have competitive advantages in their home markets. In addition, our business is substantially dependent on our continuing ability to compete effectively to attract and retain qualified employees, including successful FAs, investment bankers, trading professionals and other revenue-producing or support personnel.

For further information on Risks refer to Note 6 to the Consolidated Financial Statements.

## Critical Accounting Policies and Estimates

### Use of Estimates

In presenting the Consolidated Financial Statements, our management makes estimates regarding:

- Valuations of assets and liabilities requiring fair value estimates including:
  - Trading inventory and investment securities;
  - Private equity and principal investments;
  - Loans and allowance for loan losses;
- The outcome of litigation;
- The realization of deferred tax assets and tax reserves;
- Assumptions and cash flow projections used in determining whether variable interest entities ("VIEs") should be consolidated and the determination of the qualifying status of special purpose entities ("QSPEs");
- The carrying amount of goodwill and other intangible assets;
- The amortization period of intangible assets with definite lives;
- Valuation of share-based payment compensation arrangements;
- Insurance reserves and recovery of insurance deferred acquisition costs; and
- Other matters that affect the reported amounts and disclosure of contingencies in the financial statements.

Estimates, by their nature, are based on judgment and available information. Therefore, actual results could differ from those estimates and could have a material impact on the Consolidated Financial Statements, and it is possible that such changes could occur in the near term. For more information regarding the specific methodologies used in determining estimates, refer to Use of Estimates in Note 1 to the Consolidated Financial Statements.

The following is a summary of our critical accounting policies and estimates.

## Valuation of Financial Instruments

Proper valuation of financial instruments is a critical component of our financial statement preparation. Fair values for exchange-traded securities and certain exchange-traded derivatives, principally futures and certain options, are based on quoted market prices. Fair values for over-the-counter ("OTC") derivative financial instruments, principally forwards, options, and swaps, represent amounts estimated to be received from or paid to a third party in settlement of these instruments. These derivatives are valued using pricing models based on the net present value of estimated future cash flows, and directly observed prices from exchange-traded derivatives, other OTC trades, or external pricing services, while taking into account the counterparty's credit ratings, or our own credit ratings as appropriate.

New and/or complex instruments may have immature or limited markets. As a result, the pricing models used for valuation often incorporate significant estimates and assumptions, which may impact the level of precision in the Consolidated Financial Statements. For long-dated and illiquid contracts, we apply extrapolation methods to observed market data in order to estimate inputs and assumptions that are not directly observable. This enables us to mark-to-market all positions consistently when only a subset of prices is directly observable. Values for OTC derivatives are verified using observed information about the costs of hedging the risk and other trades in the market. As the markets for these products develop, we continually refine our pricing models based on experience to correlate more closely to the market risk of these instruments. Obtaining the fair value for OTC derivative contracts requires the use of management judgment and estimates. At the inception of the contract, unrealized gains for these instruments are not recognized unless significant inputs to the valuation model are observable in the market.

We hold investments that may have quoted market prices but that are subject to restrictions (e.g., consent of the issuer or other investors to sell) that may limit our ability to realize the quoted market price. Accordingly, we estimate the fair value of these securities based on management's best estimate, which incorporates pricing models based on projected cash flows, earnings multiples, comparisons based on similar market transactions and/or review of underlying financial conditions and other market factors.

Valuation adjustments are an integral component of the mark-to-market process and may be taken where either the sheer size of the trade or other specific features of the trade or particular market (such as counterparty credit quality, concentration or market liquidity) requires adjustment to the values derived from the pricing models.

Because valuation may involve significant estimation where readily observable prices are not available, we have categorized our financial instruments based on liquidity of the instrument and the amount of estimation we make when determining its value as recorded in the Consolidated Financial Statements. In preparing the categorization, we have made estimates regarding the allocation of netting adjustments permitted under FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*, and other adjustments.

Assets and liabilities recorded on the Consolidated Balance Sheets can be broadly categorized as follows:

*Category 1.* Highly liquid cash, securities and derivative instruments, primarily carried at fair value, for which quoted market prices are readily available (for example, exchange-traded equity securities, certain listed options, and U.S. Government securities).

*Category 2.* Liquid instruments, primarily carried at fair value, including:

a) Cash instruments for which quoted prices are available but which trade less frequently such that there may not be complete pricing transparency for these instruments across all market cycles (for example, corporate and municipal bonds and certain physical commodities);
b) Derivative instruments that are valued using a model, where inputs to the model are directly observable in the market (for example, U.S. dollar interest rate swaps); and
c) Instruments that are priced with reference to financial instruments whose parameters can be directly observed (for example, certain mortgage loans).

*Category 3.* Less liquid instruments that are valued using management's best estimate of fair value, and instruments which are valued using a model, where either the inputs to the model and/or the models themselves require significant judgment by management. Areas where these valuation methodologies are primarily applied include private equity investments, long-dated or complex derivatives such as certain

foreign exchange options and credit default swaps, and distressed debt and commodity derivatives, such as long-dated options on gas and power and weather derivatives. In applying these models, we consider such factors as projected cash flows, market comparables, volatility, and various market inputs.

At December 29, 2006 and December 30, 2005, certain assets and liabilities on the Consolidated Balance Sheets can be categorized using the above classification scheme as follows:

(dollars in millions)

| 2006 | Category 1 | Category 2 | Category 3 | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Trading assets, excluding contractual agreements | **$ 76,519** | **$ 91,446** | **$ 3,970** | **$ 171,935** |
| Contractual agreements | **4,974** | **23,698** | **3,241** | **31,913** |
| Investment securities(1) (2) | **6,239** | **62,279** | **14,892** | **83,410** |
| **Liabilities** | | | | |
| Trading liabilities, excluding contractual agreements | **$ 49,068** | **$ 11,441** | **$ 42** | **$ 60,551** |
| Contractual agreements | **6,633** | **22,703** | **8,975** | **38,311** |
| **2005** | | | | |
| **Assets** | | | | |
| Trading assets, excluding contractual agreements | $ 56,556 | $ 63,344 | $ 2,594 | $ 122,494 |
| Contractual agreements | 5,008 | 18,177 | 3,031 | 26,216 |
| Investment securities(1) | 6,115 | 54,805 | 8,353 | 69,273 |
| **Liabilities** | | | | |
| Trading liabilities, excluding contractual agreements | $ 48,688 | $ 11,248 | $ 242 | $ 60,178 |
| Contractual agreements | 4,623 | 17,490 | 6,642 | 28,755 |

(1) Includes investments that are not carried at fair value. See Note 5 to the Consolidated Financial Statements for additional information on investment securities.

(2) The increase in category 3 investment securities from year-end 2005 to year-end 2006 primarily relates to increases in private equity investments.

In addition, other trading-related assets recorded in the Consolidated Balance Sheets at year-end 2006 and 2005 include $297.0 billion and $255.5 billion, respectively, of receivables under resale agreements and receivables under securities borrowed transactions. Trading-related liabilities recorded in the Consolidated Balance Sheets at year-end 2006 and 2005 include $266.1 billion and $212.4 billion, respectively, of payables under repurchase agreements and payables under securities loaned transactions. We have recorded these securities financing transactions at their contractual amounts, which approximate fair value, and little or no estimation is required by management.

## Litigation

We have been named as a defendant in various legal actions, including arbitrations, class actions, and other litigation arising in connection with our activities as a global diversified financial services institution. We are also involved in investigations and/or proceedings by governmental and self-regulatory agencies. In accordance with SFAS No. 5, *Accounting for Contingencies*, we will accrue a liability when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. In many lawsuits and arbitrations, including class action lawsuits, it is not possible for us to determine whether a liability has been incurred or to estimate the ultimate or minimum amount of that liability until the case is close to resolution, in which case no accrual is made until that time. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases in which claimants seek substantial or indeterminate damages, we cannot predict what the eventual loss or range of loss related to such matters will be. See Note 12 to the Consolidated Financial Statements and Other Information (Unaudited) — Legal Proceedings for further information.

## Variable Interest Entities

In the normal course of business, we enter into a variety of transactions with VIEs. We are required by the applicable accounting guidance to perform a qualitative and/or quantitative analysis of each new VIE at inception to determine whether we are the primary beneficiary of the VIE and therefore must consolidate the VIE. In performing this analysis, we make assumptions regarding future performance of assets held by the VIE, taking into account estimates of credit risk, estimates of the fair value of assets, timing of cash flows, and other significant factors. Although a VIE's actual results may differ from projected outcomes, a revised consolidation analysis is generally not required subsequent to the initial assessment. If a VIE meets the conditions to be considered a QSPE, we are not typically required to consolidate the QSPE in our financial statements. A QSPE's activities must be significantly limited. A servicer of the assets held by a QSPE may have discretion in restructuring or working out assets held by the QSPE as long as the discretion is significantly limited and the parameters of that discretion are fully described in the legal documents that established the QSPE. Determining whether the activities of a QSPE and its servicer meet these conditions requires the use of judgment by management.

## Income Taxes

Merrill Lynch is under examination by the Internal Revenue Service ("IRS") and other tax authorities including Japan and the United Kingdom, and states in which Merrill Lynch has significant business operations, such as New York. The tax years under examination vary by jurisdiction. An IRS examination covering the years 2001–2003 was completed in 2006, subject to the resolution of the Japanese issue discussed below. As previously disclosed, there were carryback claims from the years 2001 and 2002 which were under Joint Committee review. During the third quarter of 2006, Merrill Lynch received notice that the Joint Committee had not taken exception and the refund claims have now been received. As a result, Merrill Lynch's 2006 effective tax rate reflects a $296 million reduction in the tax provision. IRS audits are also in progress for the tax years 2004–2006. The IRS field audit for the 2004 and 2005 tax years is expected to be completed in 2007. New York State and City audits for the years 1997–2001 were also completed in 2006 and did not have a material impact on the Consolidated Financial Statements. In the second quarter of 2005, Merrill Lynch paid a tax assessment from the Tokyo Regional Tax Bureau for the years 1998–2002. The assessment reflected the Japanese tax authority's view that certain income on which Merrill Lynch previously paid income tax to other international jurisdictions, primarily the United States, should have been allocated to Japan. Merrill Lynch has begun the process of obtaining clarification from international authorities on the appropriate allocation of income among multiple jurisdictions to prevent double taxation. Merrill Lynch regularly assesses the likelihood of additional assessments in each of the tax jurisdictions resulting from these examinations. Tax reserves have been established, which Merrill Lynch believes to be adequate in relation to the potential for additional assessments. However, there is a reasonable possibility that additional amounts may be incurred. The estimated additional possible amounts are no more than $120 million. Merrill Lynch adjusts the level of reserves and the reasonably possible amount when there is more information available, or when an event occurs requiring a change. The reassessment of tax reserves could have a material impact on Merrill Lynch's effective tax rate in the period in which it occurs.

## Business Environment[1]

Global financial markets performed well for most of 2006 as the U.S. Federal Reserve System's Federal Open Market Committee ("FOMC") ended its two-year campaign of raising interest rates. This, coupled with a fourth consecutive year of double-digit percentage growth in corporate profits and falling oil prices, supported a U.S. stock market surge in the second half of the year. The U.S. economy performed well as the gross domestic product increased slightly compared to 2005, despite a significant slowdown in the housing market and a lower rate of consumer spending. Non-U.S. markets outperformed U.S. markets. Increased global liquidity fueled significant merger and acquisition ("M&A") activity and share buy-back activity. Long-term interest rates, as measured by the yield on the 10-year U.S. Treasury bond, began 2006 at 4.39%, rose during the middle of the year, then retreated to end the year at 4.71%. Long-term interest rates were below short-term interest rates for the majority of 2006, and the FOMC raised the federal funds rate from 4.25% to 5.25%, with its last increase in July 2006.

U.S. equity markets performed well for most of 2006 with all major U.S. equity indices increasing for the year, despite a pronounced downturn in the financial markets from mid-May through August. The Dow Jones Industrial Average, Standard & Poor's 500 Index and the Nasdaq Composite Index rose 16.3%, 13.6% and 9.5%, respectively.

Non-U.S. equity markets generally outperformed those in the U.S. The Dow Jones World Index, excluding the United States, rose 23% during the year in dollar terms. European stocks had a solid performance in 2006 as the Dow Jones Stoxx 50 index and the FTSE 100 index rose 10% and 11%, respectively. Despite a significant decline in emerging markets around the middle of the year, India and China posted strong gains for the full year with the Bombay Sensex index and the Hang Seng index increasing 47% and 34%, respectively. The Dow Jones China 88 index, a measure of China's largest and most traded stocks, rose 97% for the year. Japan's Nikkei Stock Average rose 7%, making it one of the weaker performing equity markets in 2006, primarily resulting from a weaker than anticipated economic recovery.

U.S. equity trading volumes for 2006 were higher than in 2005. On the NYSE and the Nasdaq both the dollar volume of shares and the number of shares traded increased compared to the prior year. U.S. equity market volatility was mixed, as measured by the VIX and QQV volatility indices.

Global debt underwriting volumes increased to $6.5 trillion, up 9% from 2005, while global equity underwriting volumes of $735 billion were up 29% from 2005. The value of global initial public offerings was a record $214 billion in 2006.

Global M&A activity increased significantly in 2006 with the total value of announced deals rising 35% to $4.0 trillion, making it the most active year since 2000. The total value of global completed M&A activity was $3.4 trillion, 34% higher than in 2005.

(1) Debt and equity underwriting and merger and acquisition statistics were obtained from Dealogic.

## Results of Operations

| (dollars in millions, except per share amounts) | 2006[1] | 2005 | 2004 | % Change 2006 vs. 2005 | % Change 2005 vs. 2004 |
|---|---|---|---|---|---|
| Net revenues | | | | | |
| Principal transactions | **$ 7,034** | $ 3,545 | $ 2,197 | 98% | 61% |
| Managed accounts and other fee-based revenues | **6,539** | 6,031 | 5,440 | 8 | 11 |
| Commissions | **5,952** | 5,219 | 4,720 | 14 | 11 |
| Investment banking | **4,680** | 3,797 | 3,473 | 23 | 9 |
| Revenues from consolidated investments | **570** | 438 | 346 | 30 | 27 |
| Other | **3,259** | 2,195 | 1,454 | 48 | 51 |
| Subtotal | **28,034** | 21,225 | 17,630 | 32 | 20 |
| Interest and dividend revenues | **40,588** | 26,571 | 14,989 | 53 | 77 |
| Less interest expense | **35,932** | 21,774 | 10,560 | 65 | 106 |
| Net interest profit | **4,656** | 4,797 | 4,429 | (3) | 8 |
| Gain on merger | **1,969** | – | – | N/M | N/M |
| Total net revenues | **34,659** | 26,022 | 22,059 | 33 | 18 |
| Non-interest expenses | | | | | |
| Compensation and benefits | **17,003** | 12,441 | 10,663 | 37 | 17 |
| Communications and technology | **1,844** | 1,608 | 1,461 | 15 | 10 |
| Brokerage, clearing, and exchange fees | **1,097** | 856 | 773 | 28 | 11 |
| Occupancy and related depreciation | **998** | 938 | 893 | 6 | 5 |
| Professional fees | **884** | 727 | 715 | 22 | 2 |
| Advertising and market development | **692** | 599 | 533 | 16 | 12 |
| Expenses of consolidated investments | **380** | 258 | 231 | 47 | 12 |
| Office supplies and postage | **226** | 210 | 203 | 8 | 3 |
| Other | **1,109** | 1,154 | 751 | (4) | 54 |
| Total non-interest expenses | **24,233** | 18,791 | 16,223 | 29 | 16 |
| Earnings before income taxes | **10,426** | 7,231 | 5,836 | 44 | 24 |
| Income tax expense | **2,927** | 2,115 | 1,400 | 38 | 51 |
| Net earnings | **$ 7,499** | $ 5,116 | $ 4,436 | 47 | 15 |
| Earnings per common share | | | | | |
| Basic | **$ 8.42** | $ 5.66 | $ 4.81 | 49 | 18 |
| Diluted | **$ 7.59** | $ 5.16 | $ 4.38 | 47 | 18 |
| Return on average common stockholders' equity | **21.3%** | 16.0% | 14.9% | | |
| Pre-tax profit margin | **30.1%** | 27.8% | 26.5% | | |
| Compensation and benefits as a percentage of net revenues | **49.1%** | 47.8% | 48.3% | | |
| Non-compensation expenses as a percentage of net revenues | **20.9%** | 24.4% | 25.2% | | |
| Book value per share | **$ 41.35** | $ 35.82 | $ 32.99 | 15 | 9 |

N/M = Not Meaningful

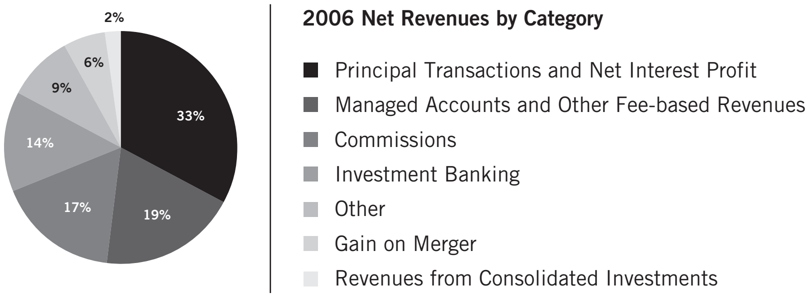
(1) Includes the one-time first quarter compensation expenses associated with the adoption of SFAS No. 123 as revised in 2004, *Share-Based Payment*, a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* ("SFAS No. 123R") and the third quarter positive net impact from the closing of the BlackRock merger. For more information on SFAS No. 123R or the BlackRock merger, refer to Notes 1 and 2, respectively, to the Consolidated Financial Statements.

## Consolidated Results of Operations

Our net earnings per diluted share were a record $7.59 in 2006 up 47% from $5.16 in 2005. Net earnings were a record $7.5 billion in 2006, up 47% from 2005 on net revenues of $34.7 billion, an increase of 33% from 2005. The 2006 results included the net gain arising from the closing of the BlackRock merger during the third quarter, which was essentially offset by one-time non-cash compensation costs arising from modifications to the retirement eligibility requirements for existing stock-based employee compensation awards and the adoption of SFAS No. 123R, recorded in the first quarter.

These items, in aggregate, increased both full year net revenues and non-interest expenses by approximately $2.0 billion, resulting in a negative net impact to 2006 net earnings of $72 million, or $0.09 per diluted share. See Exhibit 99.1, filed with our 2006 Form 10-K, for further information on these one-time items.

The following chart illustrates the composition of net revenues by category in 2006:




**2006 compared to 2005**

Principal transactions revenues include realized gains and losses from the purchase and sale of securities, such as equity securities and fixed income securities including government bonds and municipal securities, in which we act as principal, as well as unrealized gains and losses on trading assets and liabilities, including commodities, derivatives, and loans. Principal transactions revenues were $7.0 billion, 98% higher than a year ago, due primarily to increased revenues from trading of fixed income, currency, commodity and equity products with the strongest increases coming from credit products, commodities and proprietary trading. These increases reflect higher client flows, increased proprietary trading activities and the impact of overall higher markets during most of 2006.

Net interest profit is a function of (i) the level and mix of our total assets and liabilities, including trading assets owned, deposits, financing and lending transactions and trading strategies associated with our institutional securities business, and (ii) the prevailing level, term structure and volatility of interest rates. Net interest profit is an integral component of our trading activity. In assessing the profitability of our client facilitation and trading activities, we view principal transactions and net interest profit in the aggregate as net trading revenues. Changes in the composition of trading inventories and hedge positions can cause the mix of principal transactions and net interest profit to fluctuate. Net interest profit was $4.7 billion, down 3% from 2005, due primarily to the impact of rising rates on municipal and equity derivatives and increased interest expense from higher long-term borrowings and funding charges, partially offset by higher short-term interest rates on deposit spreads earned.

Managed accounts and other fee-based revenues primarily consist of asset-priced portfolio service fees earned from the administration of separately managed and other investment accounts for retail investors, annual account fees, and certain other account-related fees. In addition, until the BlackRock merger at the end of the third quarter of 2006, managed accounts and other fee-based revenues also included fees earned from the management and administration of retail mutual funds and institutional funds such as pension assets, and performance fees earned on certain separately managed accounts and institutional money management arrangements. Managed accounts and other fee-based revenues were $6.5 billion, up 8% from 2005. The increase is mainly due to higher portfolio service fees reflecting the impact of net inflows into annuitized-revenue accounts as well as higher equity market values. As a result of the BlackRock merger, managed accounts and other fee-based revenues only reflect nine months of operations associated with MLIM for 2006. For more information on the BlackRock merger, please refer to Note 2 to the Consolidated Financial Statements.

Commissions revenues primarily arise from agency transactions in listed and OTC equity securities and commodities, insurance products and options. Commissions revenues also include distribution fees for promoting and distributing mutual funds ("12b-1 fees") and hedge funds, as well as contingent deferred sales charges earned when a shareholder redeems shares prior to the end of the required holding period. Commissions revenues were $6.0 billion, up 14% from 2005, due primarily to a global increase in client transaction volumes, particularly in listed equities and mutual funds.

Investment banking revenues include (i) origination revenues representing fees earned from the underwriting of debt, equity and equity-linked securities, as well as loan syndication and commitment fees and (ii) strategic advisory services revenues including merger and acquisition and other investment banking advisory fees. Investment banking revenues were $4.7 billion, up 23% from 2005, reflecting increases in both debt and equity origination revenues as well as increases in merger and acquisition advisory revenues, driven by increased overall activity.

Other revenues include realized investment gains and losses, distributions on cost method investments, fair value adjustments on private equity investments that are held for capital appreciation and/or current income, gains related to the sale of mortgages, write-downs of certain available-for-sale securities, and translation gains and losses on foreign denominated assets and liabilities. Other revenues were $3.3 billion in 2006, up 48% from 2005 due primarily to higher revenues from private equity businesses and gains from the sale of mortgages and other loans, partially offset by lower net foreign exchange gains.

The gain on merger was $2.0 billion for 2006. This gain entirely relates to the BlackRock merger. For more information on this merger, refer to Note 2 to the Consolidated Financial Statements.

Revenues from consolidated investments include revenues from investments that are consolidated under SFAS No. 94, *Consolidation of All Majority-owned Subsidiaries* and FASB Interpretation No. 46, *Consolidation of Variable Interest Entities – an interpretation of APB No. 51* ("FIN 46R"). Revenues from consolidated investments were $570 million, up 30% from 2005, reflecting higher investment gains and additional investments.

Compensation and benefits expenses were $17.0 billion in 2006, up 37% from a year-ago, reflecting higher incentive compensation accruals associated with increased net revenues, as well as higher staffing levels. Our 2006 compensation and benefit expenses also reflect the non-cash compensation expenses incurred in the first quarter of 2006 of $1.8 billion related to the adoption of SFAS No. 123R. Compensation and benefits expenses were 49.1% of net revenues for 2006, as compared to 47.8% a year ago. Excluding the one-time impacts related to the adoption of SFAS No. 123R and the BlackRock merger, compensation and benefits were 46.2% of net revenues. See Exhibit 99.1, filed with 2006 Form 10-K, for a reconciliation of non-GAAP measures. The compensation ratio depends on the absolute level of net revenues, the business mix underlying those revenues and industry compensation trends.

Non-compensation expenses were $7.2 billion in 2006, up 14% from 2005. Communications and technology costs were $1.8 billion, up 15% from 2005, due primarily to costs related to technology investments for growth, including acquisitions, and higher market information and communications costs. Brokerage, clearing and exchange fees were $1.1 billion, up 28% from 2005, mainly due to increased transaction volumes. Professional fees were $884 million, up 22% from 2005, reflecting higher legal and consulting fees primarily associated with increased business activity levels. Advertising and market development expenses were $692 million, up 16% from 2005, due primarily to higher travel expenses associated with increased business activity levels and increased sales promotion and advertising costs. Expenses of consolidated investments were $380 million, up from $258 million in 2005, principally due to increased minority interest expenses associated with related increased revenues from consolidated investments.

**2005 compared to 2004**

Net revenues in 2005 were $26.0 billion, 18% higher than in 2004. Managed accounts and other fee-based revenues in 2005 were $6.0 billion, up 11%, reflecting the impact of net inflows into annuitized-revenue products, and the increase in managed account fees which reflects the impact of net inflows of higher-yielding assets as well as higher equity market values. Principal transactions revenues in 2005 increased 61%, to $3.5 billion, due primarily to increased revenues from trading of debt and equity products, as well as our addition of the commodities business, which was acquired in November 2004. Commission revenues in 2005 were $5.2 billion, up 11% due primarily to a global increase in client transaction volumes, particularly in listed equities and mutual funds. Net interest profit in 2005 was $4.8 billion, up 8% due primarily to the impact of rising short-term interest rates on deposit spreads earned. Investment banking revenues of $3.8 billion in 2005 increased 9% from 2004 due to increased M&A advisory revenues as well as higher debt origination fees. Revenues from consolidated investments were $438 million, up from $346 million in 2004 reflecting higher investment gains. Other revenues were $2.2 billion, up from $1.5 billion due primarily to higher revenues in principal investing and private equity businesses.

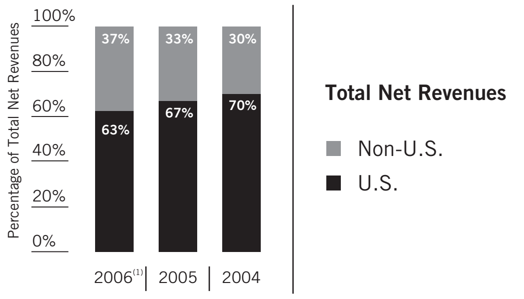
Compensation and benefits expenses were $12.4 billion in 2005, up 17% from 2004 reflecting higher incentive compensation accruals associated with increased net revenues, as well as higher staffing levels. Compensation and benefits expenses were 47.8% of net revenues in 2005, compared to 48.3% of net revenues in 2004.

Non-compensation expenses were $6.4 billion in 2005, 14% higher than 2004. Communications and technology costs were $1.6 billion, up 10%, due primarily to higher system consulting costs related to investments for growth, including acquisitions, and higher market information and communications costs. Other expenses were $1.2 billion, up from $751 million in 2004, primarily reflecting higher litigation provisions.

## Income Taxes

Our 2006 income tax provision was $2.9 billion representing a 28.1% effective tax rate compared with 29.2% in 2005 and reflected a $296 million reduction in the tax provision arising from carry-back claims covering the years 2001 and 2002. Our 2005 tax provision was $2.1 billion and the effective tax rate increased from the 2004 rate of 24.0% reflecting the net impact of the business mix, tax settlements, and $97 million of tax associated with the repatriation of $1.8 billion of foreign earnings. We have recorded deferred tax assets and liabilities for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the Consolidated Financial Statements. We assess our ability to realize deferred tax assets within each jurisdiction, primarily based on a strong earnings history and other factors as discussed in SFAS No. 109, *Accounting for Income Taxes*. During the last 10 years, average annual pre-tax earnings were $4.5 billion. Accordingly, management believes that it is more likely than not those remaining deferred tax assets, net of the remaining related valuation allowance, will be realized. See Note 15 to the Consolidated Financial Statements for further information.

The following chart illustrates U.S. and non-U.S. net revenues as a percentage of total net revenues.




(1) Excludes the net gain of approximately $2.0 billion resulting from the closing of the BlackRock merger.

For further geographic information, including our earnings by region and the methodology used in preparing this data, refer to Note 3 to the Consolidated Financial Statements.

## Consolidated Balance Sheets

### Overview

We continuously monitor and evaluate the size and composition of the Consolidated Balance Sheets. The following table summarizes the year-end and average balance sheets for 2006 and 2005:

| (dollars in billions) | **Dec. 29, 2006** | 2006 Average(1) | Dec. 30, 2005 | 2005 Average(1) |
|---|---|---|---|---|
| **Assets** | | | | |
| **Trading-Related** | | | | |
| Securities financing assets | **$ 321.9** | $362.1 | $272.3 | $268.3 |
| Trading assets | **203.8** | 193.9 | 148.7 | 182.9 |
| Other trading-related receivables | **71.7** | 69.5 | 54.3 | 60.9 |
| | **597.4** | 625.5 | 475.3 | 512.1 |
| **Non-Trading-Related** | | | | |
| Cash | **45.6** | 37.8 | 26.5 | 38.7 |
| Investment securities | **83.4** | 70.8 | 69.3 | 71.2 |
| Loans, notes, and mortgages, net | **73.0** | 71.0 | 66.0 | 60.6 |
| Other non-trading assets | **41.9** | 43.0 | 43.9 | 47.8 |
| | **243.9** | 222.6 | 205.7 | 218.3 |
| **Total assets** | **$ 841.3** | $848.1 | $681.0 | $730.4 |
| **Liabilities** | | | | |
| **Trading-Related** | | | | |
| Securities financing liabilities | **$ 291.0** | $332.7 | $229.2 | $265.2 |
| Trading liabilities | **98.9** | 117.9 | 88.9 | 105.7 |
| Other trading-related payables | **75.6** | 80.2 | 56.9 | 63.8 |
| | **465.5** | 530.8 | 375.0 | 434.7 |
| **Non-Trading-Related** | | | | |
| Short-term borrowings | **18.1** | 17.1 | 9.0 | 13.9 |
| Deposits | **84.1** | 81.1 | 80.0 | 79.2 |
| Long-term borrowings | **181.4** | 141.3 | 132.4 | 122.4 |
| Junior subordinated notes (related to trust preferred securities) | **3.8** | 3.1 | 3.1 | 3.1 |
| Other non-trading liabilities | **49.4** | 37.3 | 45.9 | 43.9 |
| | **336.8** | 279.9 | 270.4 | 262.5 |
| **Total liabilities** | **802.3** | 810.7 | 645.4 | 697.2 |
| **Total stockholders' equity** | **39.0** | 37.4 | 35.6 | 33.2 |
| **Total liabilities and stockholders' equity** | **$ 841.3** | $848.1 | $681.0 | $730.4 |

(1) Averages represent our daily balance sheet estimates, which may not fully reflect netting and other adjustments included in period-end balances. Balances for certain assets and liabilities are not updated on a daily basis.

The discussion that follows analyzes the changes in year-end financial statement balances and yearly average balances of the major asset and liability categories.

## Risk Governance Structure

Our risk governance structure is comprised of the Audit Committee and the Finance Committee, the Executive Committee, the ROC, the business units, the independent risk and control groups, and various other corporate governance committees.

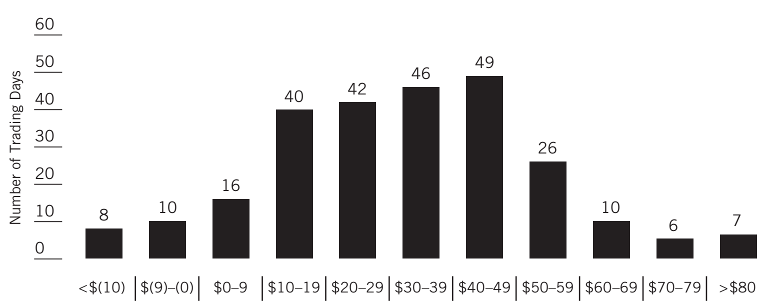
The Audit Committee, which is comprised entirely of independent directors, reviews and oversees management's policies and processes for managing all major categories of risk affecting the firm, including operational, legal and reputational risks. In addition, the Audit Committee also approves the ROC charter and has authorized the ROC to establish our risk management policies. The Finance Committee, which is also comprised entirely of independent directors, is responsible for reviewing our policies and procedures for managing exposure to market, credit and liquidity risk, including risk limits for both market and credit risk, Value at Risk ("VaR"), liquidity models, and other relevant models. The Executive Committee, a group comprised of executive management, approves the risk tolerance levels established by the ROC and receives regular updates from the ROC on risk-related matters. The Executive Committee pays particular attention to risk concentrations and liquidity concerns.

The ROC is comprised of senior business and control managers and is chaired by our Chief Financial Officer. The ROC establishes risk tolerance levels for the firm and authorizes material changes in our risk profile. The ROC works to ensure that the risks that we assume are managed within these tolerance levels and verifies that we have implemented appropriate processes to identify, measure, monitor and manage our risks.

Market and credit risk tolerance levels are represented in part by framework limits, which are established by the ROC and reviewed and approved annually by the Executive Committee, which must also approve certain intra-year changes. Substantive market and credit risk framework limit changes are reported to the Audit and Finance Committees. The frameworks are reviewed by the Finance Committee in the context of its evaluation of market and credit risk exposures. Risk framework exceptions and violations are reported and investigated at predefined and appropriate levels of management.

Both the Audit Committee and the Finance Committee are provided with regular risk updates, and significant issues and transactions are reported to the Executive Committee, the Audit Committee and the Finance Committee. Various governance committees exist to create policy, review activity, and verify that new and existing business initiatives remain within established risk tolerance levels. Representatives of the independent risk and control groups participate as voting members of these committees. The activities of these committees are monitored by the ROC.

The overall effectiveness of our risk processes and policies can be seen on a broader level when analyzing daily net trading revenues over time. Our policies and procedures for monitoring and controlling risk, combined with the businesses' focus on customer order-flow-driven revenues and selective proprietary positioning have helped us to mitigate earnings volatility within our trading portfolios. While no guarantee can be given regarding future earnings volatility, we will continue to pursue policies and procedures that assist us in measuring and monitoring our risks. The histogram below shows the distribution of daily net revenues from our trading businesses (principal transactions and net interest profit) for 2006.




**2006 Distribution of Daily Net-Trading Revenues**
(dollars in millions)

## Market Risk

We define market risk as the potential change in value of financial instruments caused by fluctuations in interest rates, exchange rates, equity and commodity prices, credit spread, and/or other risks. We have a Market Risk Framework that defines and communicates our market risk tolerance and broad overall limits across Merrill Lynch by defining and constraining exposure to specific asset classes, market risk factors and value at risk, or VaR. VaR is a statistical measure of the potential loss in the fair value of a portfolio due to adverse movements in underlying risk factors.

Our Market Risk Management Group and other independent risk and control groups are responsible for approving the products and markets in which our business units and functions will transact and take risk. Moreover, this group is responsible for identifying the risks to which these business units will be exposed in these approved products and markets. Market Risk Management uses a variety of quantitative methods to assess the risk of our positions and portfolios. In particular, Market Risk Management quantifies the sensitivities of our

current portfolios to changes in market variables. These sensitivities are then utilized in the context of historical data to estimate earnings and loss distributions that our current portfolios would have incurred throughout the historical period. From these distributions, Market Risk Management derives a number of useful risk statistics, including VaR.

The VaR disclosed in the accompanying table is an estimate of the amount that our current trading portfolios could lose with a specified degree of confidence, over a given time interval. The aggregate VaR for our trading portfolios is less than the sum of the VaRs for individual risk categories because movements in different risk categories occur at different times and, historically, extreme movements have not occurred in all risk categories simultaneously. The difference between the sum of the VaRs for individual risk categories and the VaR calculated for all risk categories is shown in the following table and may be viewed as a measure of the diversification within our portfolios. We believe that the tabulated risk measures provide broad guidance as to the amount we could lose in future periods, and we work continually to improve our measurement and the methodology of our VaR. However, the calculation of VaR requires numerous assumptions and thus VaR should not be viewed as a precise measure of risk. In addition, VaR is not intended to capture worst case scenario losses.

To calculate VaR, we aggregate sensitivities to market risk factors and combine them with a database of historical market factor movements to simulate a series of profits and losses. The level of loss that is exceeded in that series 5% of the time is used as the estimate for the 95% confidence level VaR. The overall total VaR amounts are presented across major risk categories, which include exposure to volatility risk found in certain products, such as options.

The table that follows presents our average and year-end VaR for trading instruments for 2006 and 2005. Additionally, high and low VaR for 2006 is presented independently for each risk category and overall. Because high and low VaR numbers for these risk categories may have occurred on different days, high and low numbers for diversification benefit would not be meaningful.

| (dollars in millions) | **Year-end 2006** | **Daily Average 2006** | **High 2006** | **Low 2006** | Year-end 2005 | Daily Average 2005 |
|---|---|---|---|---|---|---|
| Trading Value-at-Risk(1) | | | | | | |
| Interest rate and credit spread | **$ 48** | **$ 48** | **$ 66** | **$ 33** | $ 37 | $ 37 |
| Equity | **29** | **19** | **39** | **5** | 16 | 12 |
| Commodity | **13** | **11** | **22** | **4** | 6 | 8 |
| Currency | **3** | **4** | **12** | **2** | 2 | 3 |
| Subtotal(2) | **93** | **82** | | | 61 | 60 |
| Diversification benefit | **(41)** | **(32)** | | | (23) | (25) |
| Overall(3) | **$ 52** | **$ 50** | **$ 71** | **$ 30** | $ 38 | $ 35 |

(1) Based on a 95% confidence level and a one-day holding period.
(2) Subtotals are not provided for highs and lows as they are not meaningful.
(3) Overall trading VaR using a 95% confidence level and a one-week holding period was $94 million and $63 million at year-end 2006 and 2005, respectively.

Trading VaR increased during 2006 due to increased levels of equity, commodity and credit trading. If market conditions are favorable, we may increase our risk-taking in a number of our businesses, including our proprietary trading activities. These activities provide revenue opportunities while also increasing the loss potential under certain market conditions. We monitor these risk levels on a daily basis to verify they remain within corporate risk guidelines and tolerance levels.

To complement VaR and in recognition of its inherent limitations, we use a number of additional risk measurement methods and tools as part of our overall market risk management process. These include stress testing and event risk analysis, which examine portfolio behavior under significant adverse market conditions, including scenarios that would result in material losses for the firm.

**Non-Trading Market Risk**

Non-trading market risk includes the risks associated with certain non-trading activities, including investment securities, securities financing transactions and equity and certain principal investments. Also included are the risks related to funding activities. Risks related to lending activities are covered in the Credit Risk section that follows.

The primary market risk of non-trading investment securities and non-trading repurchase and reverse repurchase agreements is expressed as sensitivity to changes in the general level of credit spreads which are defined as the differences in the yields on debt instruments from relevant LIBOR/Swap rates. Non-trading investment securities include securities that are classified as available-for-sale and held-to-maturity as well as investments of insurance subsidiaries. At year-end 2006, the total credit spread sensitivity of these instruments was a pre-tax loss of $24 million in fair market value for an increase of one basis point, which is one one-hundredth of a percent, in credit spreads, compared to a pre-tax loss of $19 million at year-end 2005. This change in fair market value is a measurement of economic risk which may differ significantly in magnitude and timing from the actual profit or loss that would be realized under generally accepted accounting principles.

The interest rate risk associated with the non-trading positions, together with funding activities, is expressed as sensitivity to changes in the general level of interest rates. Our funding activities include LYONs®, trust preferred securities and other long-term debt issuances together with interest rate hedges. At year-end 2006, the net interest rate sensitivity of these positions is a pre-tax loss in fair market value of $2 million for a parallel one basis point increase in interest rates across all yield curves, compared to a pre-tax loss of $1 million at year-end 2005. This change in fair market value is a measurement of economic risk which may differ significantly in magnitude and timing from the actual profit or loss that would be realized under generally accepted accounting principles.

Other non-trading equity investments include direct private equity interests, private equity fund investments, hedge fund interests, certain direct and indirect real estate investments and other principal investments. These investments are broadly sensitive to general price levels in the equity or commercial real estate markets as well as to specific business, financial and credit factors which influence the performance and valuation of each investment uniquely. Refer to Note 5 to the Consolidated Financial Statements for additional information on these investments.

## Credit Risk

We define credit risk as the potential for loss that can occur as a result of an individual, counterparty or issuer being unable or unwilling to honor its contractual obligations to us. The Credit Risk Framework is the primary tool that we use to communicate firm-wide credit limits and monitor exposure by constraining the magnitude and tenor of exposure to counterparty and issuer families. Additionally, we have country risk limits that constrain total aggregate exposure across all counterparties and issuers (including sovereign entities) for a given country within predefined tolerance levels.

We have a Global Credit and Commitments Group that assesses the creditworthiness of existing and potential individual clients, institutional counterparties and issuers, and determines firm-wide credit risk levels within the Credit Risk Framework among other tools. This group reviews and monitors specific transactions as well as portfolio and other credit risk concentrations both within and across businesses. This group is also responsible for ongoing monitoring of credit quality and limit compliance and actively works with all of our business units to manage and mitigate credit risk.

The Global Credit and Commitments Group uses a variety of methodologies to set limits on exposure and potential loss resulting from an individual, counterparty or issuer failing to fulfill its contractual obligations. The group performs analyses in the context of industrial, regional, and global economic trends and incorporates portfolio and concentration effects when determining tolerance levels. Credit risk limits take into account measures of both current and potential exposure as well as potential loss and are set and monitored by broad risk type, product type, and maturity. Credit risk mitigation techniques include, where appropriate, the right to require initial collateral or margin, the right to terminate transactions or to obtain collateral should unfavorable events occur, the right to call for collateral when certain exposure thresholds are exceeded, the right to call for third party guarantees and the purchase of credit default protection. With senior management involvement, we conduct regular portfolio reviews, monitor counterparty creditworthiness, and evaluate potential transaction risks with a view toward early problem identification and protection against unacceptable credit-related losses. We continue to invest additional resources to enhance Merrill Lynch's methods and policies to assist in managing our credit risk and to address evolving regulatory requirements.

Senior members of the Global Credit and Commitments Group chair various commitment committees with membership across business, control and support units. These committees review and approve commitments, underwritings and syndication strategies related to debt, syndicated loans, equity, real estate and asset-based finance, among other products and activities.

**Commercial Lending**

Our commercial lending activities consist primarily of corporate and institutional lending, asset-based finance, commercial finance, and commercial real estate related activities. In evaluating certain potential commercial lending transactions, we use a risk-adjusted-return-on-capital model in addition to other methodologies. We typically provide corporate and institutional lending facilities to clients for general corporate purposes, backup liquidity lines, bridge financings, and acquisition-related activities. We often syndicate corporate and institutional loans through assignments and participations to unaffiliated third parties. While these facilities may be supported by credit enhancing arrangements such as property liens or claims on operating assets, we generally expect repayment through other sources including cash flow and/or recapitalization. As part of portfolio management activities, the Global Credit and Commitments Group mitigates certain exposures in the corporate and institutional lending portfolio by purchasing single name and basket credit default swaps as well as by evaluating and selectively executing loan sales in the secondary markets.

Asset-based finance facilities are typically secured by financial assets such as mortgages, auto loans, leases, credit card and other receivables. Clients often use these facilities for the origination and purchase of assets during a warehousing period leading up to securitization.

information about derivatives that meet the definition of a guarantee for accounting purposes is included in Note 12 to the Consolidated Financial Statements.

Merrill Lynch generally enters into International Swaps and Derivatives Association, Inc. master agreements or their equivalent ("master netting agreements") with each of its counterparties, as soon as possible. Master netting agreements provide protection in bankruptcy in certain circumstances and, in some cases, enable receivables and payables with the same counterparty to be offset on the Consolidated Balance Sheets, providing for a more meaningful balance sheet presentation of credit exposure. However, the enforceability of master netting agreements under bankruptcy laws in certain countries, or in certain industries, is not free from doubt and receivables and payables with counterparties in these countries or industries are accordingly recorded on a gross basis.

To reduce the risk of loss, Merrill Lynch requires collateral, principally cash and U.S. Government and agencies securities, on certain derivative transactions. Merrill Lynch nets cash collateral paid or received under credit support annexes associated with legally enforceable master netting agreements against derivative inventory. For the year ended December 29, 2006, cash collateral netted against derivative inventory was $7.2 billion. From an economic standpoint, Merrill Lynch evaluates default risk exposures net of related collateral. In addition to obtaining collateral, Merrill Lynch attempts to mitigate default risk on derivatives by entering into transactions with provisions that enable Merrill Lynch to terminate or reset the terms of the derivative contract.

Many of Merrill Lynch's derivative contracts contain provisions that could, upon an adverse change in ML & Co.'s credit rating, trigger a requirement for an early payment or additional collateral support.

## NOTE 7 Securitization Transactions and Transactions with Special Purpose Entities ("SPEs")

### Securitizations

In the normal course of business, Merrill Lynch securitizes: commercial and residential mortgage loans; municipal, government, and corporate bonds; and other types of financial assets. SPEs, often referred to as Variable Interest Entities, or VIEs, are often used when entering into or facilitating securitization transactions. Merrill Lynch's involvement with SPEs used to securitize financial assets includes: structuring and/or establishing SPEs; selling assets to SPEs; managing or servicing assets held by SPEs; underwriting, distributing, and making loans to SPEs; making markets in securities issued by SPEs; engaging in derivative transactions with SPEs; owning notes or certificates issued by SPEs; and/or providing liquidity facilities and other guarantees to SPEs.

Merrill Lynch securitized assets of approximately $147.2 billion and $90.3 billion for the years ended December 29, 2006 and December 30, 2005, respectively. For the years ended December 29, 2006 and December 30, 2005, Merrill Lynch received $148.8 billion and $91.1 billion, respectively, of proceeds, and other cash inflows, from securitization transactions, and recognized net securitization gains of $535.5 million and $425.4 million, respectively, in Merrill Lynch's Consolidated Statements of Earnings.

The table below summarizes the cash flows received by Merrill Lynch from securitization transactions related to the following asset types:

| (dollars in millions) | **2006** | 2005 |
|---|---|---|
| **Asset category** | | |
| Residential mortgage loans | **$ 97,433** | $58,002 |
| Municipal bonds | **29,482** | 17,084 |
| Corporate and government bonds | **3,870** | 2,468 |
| Commercial loans and other | **17,984** | 13,569 |
| Total | **$148,769** | $ 91,123 |

In certain instances, Merrill Lynch retains interests in the senior tranche, subordinated tranche, and/or residual tranche of securities issued by certain SPEs created to securitize assets. The gain or loss on the sale of the assets is determined with reference to the previous carrying amount of the financial assets transferred, which is allocated between the assets sold and the retained interests, if any, based on their relative fair value at the date of transfer.

Retained interests are recorded in the Consolidated Balance Sheets at fair value. To obtain fair values, observable market prices are used if available. Where observable market prices are unavailable, Merrill Lynch generally estimates fair value initially and on an ongoing basis based on the present value of expected future cash flows using management's best estimates of credit losses, prepayment rates, forward yield curves, and discount rates, commensurate with the risks involved. Retained interests are either held as trading assets, with changes in fair value recorded in the Consolidated Statements of Earnings, or as securities available-for-sale, with changes in fair value included in accumulated other comprehensive loss. Retained interests held as available-for-sale are reviewed periodically for impairment.

Retained interests in securitized assets were approximately $6.8 billion and $4.0 billion at December 29, 2006 and December 30, 2005, respectively, which related primarily to residential mortgage loan and municipal bond securitization transactions. The majority of the retained interest balance consists of mortgage-backed securities that have observable market prices. These retained interests include mortgage-backed securities that Merrill Lynch expects to sell to investors in the normal course of its underwriting activity.

The following table presents information on retained interests, excluding the offsetting benefit of financial instruments used to hedge risks, held by Merrill Lynch as of December 29, 2006, arising from Merrill Lynch's residential mortgage loan, municipal bond and other securitization transactions. The sensitivities of the current fair value of the retained interests to immediate 10% and 20% adverse changes in assumptions and parameters are also shown.

| (dollars in millions) | Residential Mortgage Loans | Municipal Bonds | Other |
|---|---|---|---|
| Retained interest amount | **$5,101** | **$ 917** | **$765** |
| Weighted average credit losses (rate per annum) | **1.0%** | **0.0%** | **0.2%** |
| Range | **0.0–6.7%** | **0.0%** | **0.0–4.8%** |
| Impact on fair value of 10% adverse change | **$ (46)** | **$ –** | **$ (2)** |
| Impact on fair value of 20% adverse change | **$ (92)** | **$ –** | **$ (3)** |
| Weighted average discount rate | **8.6%** | **4.1%** | **6.1%** |
| Range | **0.0–99.0%** | **3.5–55.0%** | **0.0–25.1%** |
| Impact on fair value of 10% adverse change | **$ (139)** | **$ (89)** | **$ (15)** |
| Impact on fair value of 20% adverse change | **$ (273)** | **$(128)** | **$ (29)** |
| Weighted average life (in years) | **3.4** | **1.1** | **0.6** |
| Range | **0.0–26.8** | **0.1–9.6** | **0.0–9.9** |
| Weighted average prepayment speed (CPR)[1] | **26.0%** | **4.7%** | **31.3%** |
| Range[1] | **0.0–70.0%** | **0.0–30.4%** | **0.0–88.0%** |
| Impact on fair value of 10% adverse change | **$ (66)** | **$ –** | **$ (1)** |
| Impact on fair value of 20% adverse change | **$ (100)** | **$ –** | **$ (1)** |

CPR=Constant Prepayment Rate

(1) Relates to select securitization transactions where assets are prepayable.

The preceding sensitivity analysis is hypothetical and should be used with caution. In particular, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated independent of changes in any other assumption; in practice, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities. Further, changes in fair value based on a 10% or 20% variation in an assumption or parameter generally cannot be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear. Also, the sensitivity analysis does not include the offsetting benefit of financial instruments that Merrill Lynch utilizes to hedge risks, including credit, interest rate, and prepayment risk, that are inherent in the retained interests. These hedging strategies are structured to take into consideration the hypothetical stress scenarios above such that they would be effective in principally offsetting Merrill Lynch's exposure to loss in the event these scenarios occur.

The weighted average assumptions and parameters used initially to value retained interests relating to securitizations that were still held by Merrill Lynch as of December 29, 2006 are as follows:

| | Residential Mortgage Loans | Municipal Bonds | Other |
|---|---|---|---|
| Credit losses (rate per annum) | **1.0%** | **0.0%** | **0.1%** |
| Weighted average discount rate | **9.2%** | **4.0%** | **4.6%** |
| Weighted average life (in years) | **3.5** | **7.0** | **0.5** |
| Prepayment speed assumption (CPR) | **25.7%** | **9.0%** | **7.1%** |

CPR=Constant Prepayment Rate

For residential mortgage loan and other securitizations, the investors and the securitization trust have no recourse to Merrill Lynch's other assets for failure of mortgage holders to pay when due.

For municipal bond securitization SPEs, in the normal course of dealer market-making activities, Merrill Lynch acts as liquidity provider. Specifically, the holders of beneficial interests issued by municipal bond securitization SPEs have the right to tender their interests for purchase by Merrill Lynch on specified dates at a specified price. Beneficial interests that are tendered are then sold by Merrill Lynch to investors through a best efforts remarketing where Merrill Lynch is the remarketing agent. If the beneficial interests are not successfully remarketed, the holders of beneficial interests are paid from funds drawn under a standby liquidity letter of credit issued by Merrill Lynch.

In addition to standby letters of credit, in certain municipal bond securitizations, Merrill Lynch also provides default protection or credit enhancement to investors in securities issued by certain municipal bond securitization SPEs. Interest and principal payments on beneficial interests issued by these SPEs are secured by a guarantee issued by Merrill Lynch. In the event that the issuer of the underlying municipal bond defaults on any payment of principal and/or interest when due, the payments on the bonds will be made to beneficial interest holders from an irrevocable guarantee by Merrill Lynch.

The maximum payout under these liquidity and default guarantees totaled $38.2 billion and $29.9 billion at December 29, 2006 and December 30, 2005, respectively. The fair value of the guarantee approximated $16 million and $14 million at December 29, 2006 and December 30, 2005, respectively, which is reflected in the Consolidated Balance Sheets. Of these arrangements, $6.9 billion at December 29, 2006 and December 30, 2005 represent agreements where the guarantee is provided to the SPE by a third-party financial intermediary and Merrill Lynch enters into a reimbursement agreement with the financial intermediary. In these arrangements, if the financial intermediary incurs losses, Merrill Lynch has up to one year to fund those losses. Additional information regarding these commitments is provided in Note 12 to the Consolidated Financial Statements.

The following table summarizes principal amounts outstanding and delinquencies of securitized financial assets as of December 29, 2006 and December 30, 2005:

| (dollars in millions) | Residential Mortgage Loans | Municipal Bonds | Other |
|---|---|---|---|
| **December 29, 2006** | | | |
| Principal Amount Outstanding(1) | **$127,482** | **$18,986** | **$ 30,337** |
| Delinquencies(2) | **3,493** | **–** | **10** |
| December 30, 2005 | | | |
| Principal Amount Outstanding(1) | $ 82,468 | $ 19,745 | $ 10,416 |
| Delinquencies | 688 | – | – |

(1) Merrill Lynch may retain an interest in the securitized financial assets.
(2) Increase in delinquencies at year-end 2006 compared to year-end 2005 is due to higher defaults associated with sub-prime lending.

Net credit losses associated with securitized financial assets for the years ended December 29, 2006 and December 30, 2005 approximated $180 million and $73 million, respectively.

**Variable Interest Entities**

In January 2003, the FASB issued FIN 46, which provides additional guidance on the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* for enterprises that have interests in entities that meet the definition of a VIE, and on December 24, 2003, the FASB issued FIN 46R. FIN 46R requires that an entity shall consolidate a VIE if that enterprise has a variable interest that will absorb a majority of the VIE's expected losses, receive a majority of the VIE's expected residual returns, or both. In April 2006, the FASB issued a FASB Staff Position FIN 46(R)-6, *Determining the Variability to be Considered in Applying FIN 46R* ("the FSP"). The FSP clarifies that the variability to be included when applying FIN 46R be based on a "by-design" approach, and should consider what risks the variable interest entity was designed to create.

QSPEs are a type of VIE that holds financial instruments and distributes cash flows to investors based on preset terms. QSPEs are commonly used in mortgage and other securitization transactions. In accordance with SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and FIN 46R, *Consolidation of Variable Interest Entities*, Merrill Lynch does not consolidate QSPEs. Information regarding QSPEs can be found in the Securitization section of this Note and the Guarantees section of Note 12 to the Consolidated Financial Statements.

Merrill Lynch has entered into transactions with a number of VIEs in which it is the primary beneficiary and therefore must consolidate the VIE; or is a significant variable interest holder in the VIE. These VIEs are as follows:

- Merrill Lynch has investments in VIEs that hold loan assets or real estate, and as a result of these loans and investments, Merrill Lynch may be either the primary beneficiary of and consolidate the VIE, or may be a significant variable interest holder. These VIEs are primarily designed to provide on- or off-balance sheet financing to clients and/or to invest in real estate. Assets held by VIEs where Merrill Lynch has provided financing and is the primary beneficiary are recorded in other assets and/or loans, notes, and mortgages in the Consolidated Balance Sheets. Assets held by VIEs where Merrill Lynch has invested in real estate partnerships and is the primary beneficiary are included in other assets. The beneficial interest holders in these VIEs have no recourse to the general credit of Merrill Lynch; their investments are paid exclusively from the assets in the VIE.
- Merrill Lynch has entered into transactions with VIEs that are used, in part, to provide tax planning strategies to investors and/or Merrill Lynch through an enhanced yield investment security. These structures typically provide financing to Merrill Lynch and/or the investor at enhanced rates. Merrill Lynch may be either the primary beneficiary of and consolidate the VIE, or may be a significant variable interest holder in the VIE. Where Merrill Lynch is the primary beneficiary, the assets held by the VIEs are primarily included in either trading or investments.

  Merrill Lynch entered into transactions with international financial institutions involving VIEs that provided to Merrill Lynch $11.75 billion in secured credit facilities and $1 billion of unsecured financing. These VIEs are also used as part of Merrill Lynch's overall tax-planning strategies and enable Merrill Lynch to borrow at more favorable rates. Merrill Lynch consolidates the VIEs as it is deemed to be the primary beneficiary of these VIEs.

- Merrill Lynch is the sponsor, guarantor, derivative counterparty, or liquidity and credit facility provider to certain mutual funds, investment entities, and conduits. Some of these funds provide a guaranteed return to investors at the maturity of the VIE. This guarantee may include a guarantee of the return of an initial investment or of the initial investment plus an agreed upon return depending on the terms of the VIE. Investors in certain of these VIEs have recourse to Merrill Lynch to the extent that the value of the assets held by the VIEs at maturity is less than the guaranteed amount. In some instances, Merrill Lynch is the primary beneficiary and must consolidate the fund. Assets held in these VIEs are primarily classified in trading. In instances where Merrill Lynch is not the primary beneficiary, the guarantees related to these funds are further discussed in Note 12 to the Consolidated Financial Statements.

  In addition, Merrill Lynch has established two asset-backed commercial paper conduits ("Conduits") and holds a significant variable interest in the Conduits in the form of 1) liquidity facilities that protect commercial paper holders against short term changes in the fair value of the assets held by the Conduits in the event of a disruption in the commercial paper market, and 2) credit facilities to the Conduits that protect commercial paper investors against credit losses for up to a certain percentage of the portfolio of assets held by the respective Conduits. The liquidity and credit facilities are further discussed in Note 12 to the Consolidated Financial Statements.
- Merrill Lynch entered into a transaction with a VIE whereby Merrill Lynch arranged for additional protection for directors and employees to indemnify them against certain losses they may incur as a result of claims against them. Merrill Lynch is the primary beneficiary and consolidates the VIE because its employees benefit from the indemnification arrangement. As of December 29, 2006 and December 30, 2005 the assets of the VIE totaled approximately $16 million, representing a purchased credit default agreement, which is recorded in other assets on the Consolidated Balance Sheets. In the event of a Merrill Lynch insolvency, proceeds of $140 million will be received by the VIE to fund any claims. Neither Merrill Lynch nor its creditors have any recourse to the assets of the VIE.

**Other Involvement with VIEs**

Merrill Lynch is involved with other VIEs in which it is neither the primary beneficiary or a significant variable interest holder; rather, its involvement relates to a significant program sponsored by Merrill Lynch. Significant programs sponsored by Merrill Lynch, which are disclosed in the table below, include the following:

- Merrill Lynch has entered into transactions with VIEs where Merrill Lynch typically purchases credit protection from the VIE in the form of a derivative in order to synthetically expose investors to a specific credit risk. These are commonly known as credit-linked note VIEs.
- Merrill Lynch has entered into transactions with VIEs where Merrill Lynch transfers convertible bonds to the VIE and retains a call option on the underlying bonds. The purpose of these VIEs is to market convertible bonds to a broad investor base by separating the bonds into callable debt and a conversion call option.

The following tables summarize Merrill Lynch's involvement with the VIEs listed above as of December 29, 2006 and December 30, 2005, respectively. The table below does not include information on QSPEs or those VIEs where Merrill Lynch is the primary beneficiary, and holds a majority of the voting interest in the entity. For more information on these entities (e.g. municipal bond securitizations), see the Securitizations section of this Note and the Guarantees section in Note 12 to the Consolidated Financial Statements.

Where an entity is a significant variable interest holder, FIN 46R requires that entity to disclose its maximum exposure to loss as a result of its interest in the VIE. It should be noted that this measure does not reflect Merrill Lynch's estimate of the actual losses that could result from adverse changes because it does not reflect the economic hedges Merrill Lynch enters into to reduce its exposure.

| (dollars in millions) | Primary Beneficiary | | | Significant Variable Interest Holder | | Other Involvement with VIEs | |
|---|---|---|---|---|---|---|---|
| Description | Total Asset Size(4) | Net Asset Size(5) | Recourse to Merrill Lynch(6) | Total Asset Size(4) | Maximum Exposure | Total Asset Size(4) | Maximum Exposure |
| **December 29, 2006** | | | | | | | |
| Loan and Real Estate VIEs | **$ 4,265** | **$ 3,787** | **$ 557** | **$ 278** | **$ 182** | **$ –** | **$ –** |
| Guaranteed and Other Funds(1) | **2,476** | **1,913** | **564** | **6,156** | **6,142** | **–** | **–** |
| Credit-Linked Note and Other VIEs(2) | **518** | **518** | **302** | **–** | **–** | **11,069** | **927** |
| Tax Planning VIEs(3) | **230** | **225** | **–** | **483** | **–** | **–** | **–** |
| December 30, 2005 | | | | | | | |
| Loan and Real Estate VIEs | $ 5,144 | $ 5,140 | $ – | $ 116 | $ 63 | $ – | $ – |
| Guaranteed and Other Funds(1) | 1,802 | 1,349 | 464 | 2,981 | 2,973 | – | – |
| Credit-Linked Note and Other VIEs(2) | 130 | 30 | – | – | – | 8,835 | 780 |
| Tax Planning VIEs(3) | 1,972 | 1,972 | – | 5,416 | 2,297 | – | – |

(1) The maximum exposure for Guaranteed and Other Funds is the fair value of Merrill Lynch's investment, derivatives entered into with the VIEs if they are in an asset position and any recourse beyond the assets of the entity.

(2) The maximum exposure for Credit-Linked Note and Other VIEs is the fair value of the derivatives entered into with the VIEs if they are in an asset position.

(3) The maximum exposure for Tax Planning VIEs reflects the fair value of investments in the VIEs and derivatives entered into with the VIEs, as well as the maximum exposure to loss associated with indemnifications made by Merrill Lynch to investors in the VIEs.

(4) This column reflects the total size of the assets held in the VIE.

(5) This column reflects the size of the assets held in the VIE after accounting for intercompany eliminations and any balance sheet netting of assets and liabilities as permitted by FIN 39.

(6) This column reflects the extent, if any, to which investors have recourse to Merrill Lynch beyond the assets held in the VIE.

## NOTE 16 Regulatory Requirements and Dividend Restrictions

Effective January 1, 2005, Merrill Lynch became a Consolidated Supervised Entity ("CSE") as defined by the SEC. As a CSE, Merrill Lynch is subject to group-wide supervision, which requires Merrill Lynch to compute allowable capital and risk allowances on a consolidated basis. Merrill Lynch is in compliance with applicable CSE standards.

Certain U.S. and non-U.S. subsidiaries are subject to various securities, banking, and insurance regulations and capital adequacy requirements promulgated by the regulatory and exchange authorities of the countries in which they operate. These regulatory restrictions may impose regulatory capital requirements and limit the amounts that these subsidiaries can pay in dividends or advance to Merrill Lynch. Merrill Lynch's principal regulated subsidiaries are discussed below.

### Securities Regulation

As a registered broker-dealer and futures commission merchant, MLPF&S is subject to the net capital requirements of Rule 15c3-1 under the Securities Exchange Act of 1934 ("the Rule"). Under the alternative method permitted by the Rule, the minimum required net capital, as defined, shall be the greater of 2% of aggregate debit items ("ADI") arising from customer transactions or $500 million. At December 29, 2006, MLPF&S's regulatory net capital of $2,719 million was approximately 16.3% of ADI, and its regulatory net capital in excess of the minimum required was $2,213 million.

MLPF&S is also subject to the capital requirements of the Commodity Futures Trading Commission ("CFTC"), which requires that minimum net capital should not be less than 8% of the total customer risk margin requirement plus 4% of the total non-customer risk margin requirement. MLPF&S substantially exceeds both standards.

MLI, a U.K. regulated investment firm, is subject to capital requirements of the FSA. Financial resources, as defined, must exceed the total financial resources requirement of the FSA. At December 29, 2006, MLI's financial resources were $11,664 million, exceeding the minimum requirement by $1,759 million.

MLGSI, a primary dealer in U.S. Government securities, is subject to the capital adequacy requirements of the Government Securities Act of 1986. This rule requires dealers to maintain liquid capital in excess of market and credit risk, as defined, by 20% (a 1.2-to-1 capital-to-risk standard). At December 29, 2006, MLGSI's liquid capital of $1,644 million was 199.0% of its total market and credit risk, and liquid capital in excess of the minimum required was $652 million.

MLJS, a Japan-based regulated broker-dealer, is subject to capital requirements of the Japanese Financial Services Agency ("JFSA"). Net capital, as defined, must exceed 120% of the total risk equivalents requirement of the JFSA. At December 29, 2006, MLJS's net capital was $1,369 million, exceeding the minimum requirement by $714 million.

### Banking Regulation

Merrill Lynch Bank USA ("MLBUSA") is a Utah-chartered industrial bank, regulated by the Federal Deposit Insurance Corporation ("FDIC") and the State of Utah Department of Financial Institutions ("UTDFI"). Merrill Lynch Bank & Trust Co., FSB ("MLBT-FSB") is a full service thrift institution regulated by the Office of Thrift Supervision ("OTS"), whose deposits are insured by the FDIC. Both MLBUSA and MLBT-FSB are required to maintain capital levels that at least equal minimum capital levels specified in federal banking laws and regulations. Failure to meet the minimum levels will result in certain mandatory, and possibly additional discretionary, actions by the regulators that, if undertaken, could have a direct material effect on the banks. The following table illustrates the actual capital ratios and capital amounts for MLBUSA and MLBT-FSB as of December 29, 2006.

| | | MLBUSA | | MLBT-FSB | |
|---|---|---|---|---|---|
| (dollars in millions) | Well Capitalized Minimum | Actual Ratio | Actual Amount | Actual Ratio | Actual Amount |
| **Tier 1 leverage** | 5% | 8.92% | $5,524 | 7.18% | $ 941 |
| **Tier 1 capital** | 6% | 9.24 | 5,524 | 8.35 | 941 |
| **Total capital** | 10% | 10.75 | 6,429 | 11.74 | 1,323 |

As a result of its ownership of MLBT-FSB, ML & Co. is registered with the OTS as a savings and loan holding company ("SLHC") and subject to regulation and examination by the OTS as a SLHC. ML & Co. is classified as a unitary SLHC, and will continue to be so classified as long as it and MLBT-FSB continue to comply with certain conditions. Unitary SLHCs are exempt from the material restrictions imposed upon the activities of SLHCs that are not unitary SLHCs. SLHCs other than unitary SLHCs are generally prohibited from engaging in activities other than conducting business as a savings association, managing or controlling savings associations, providing services to subsidiaries or engaging in activities permissible for bank holding companies. Should ML & Co. fail to continue to qualify as a unitary SLHC, in order to continue its present businesses that would not be permissible for a SLHC, ML & Co. could be required to divest control of MLBT-FSB.

In July 2006, Merrill Lynch Trust Company, FSB ("MLTC-FSB") received approval from the OTS to become a full service thrift institution as part of an internal reorganization of certain banking businesses of Merrill Lynch. On August 5, 2006, Merrill Lynch Bank & Trust Co. ("MLB&T"), an existing FDIC-insured depository institution, was merged into MLTC-FSB, and MLTC-FSB was renamed Merrill Lynch Bank & Trust Co., FSB.

MLIB, an Ireland-based regulated bank, is subject to the capital requirements of the Financial Regulator of Ireland. MLIB is required to meet minimum regulatory capital requirements under the European Union ("EU") banking law as implemented in Ireland by the Financial Regulator. At December 29, 2006, MLIB's capital ratio was above the minimum requirement at 11.06% and its financial resources were $6,646 million, exceeding the minimum requirement by $1,840 million.

Prior to April 28, 2006, MLIB was an indirect subsidiary of Merrill Lynch International Finance Corporation ("MLIFC") and was subject to capital requirements imposed by the State of New York Banking Department. Pursuant to an internal corporate reorganization, MLIFC is no longer an indirect parent company of MLIB, and therefore MLIB is no longer subject to such capital requirements.

On September 30, 2006, Merrill Lynch completed an internal reorganization of its international banking structure, when the entire business of mlib (historic) (the UK entity previously known as Merrill Lynch International Bank Limited, and authorized by the FSA) was transferred to MLIB after obtaining all necessary regulatory approvals and pursuant to High Court Orders granted in London and Singapore. The two entities were renamed as part of this reorganization. Following the transfer, mlib (historic) has been deauthorized by the FSA and is therefore no longer subject to any capital requirements imposed by the FSA.

### Insurance Regulation

Merrill Lynch's insurance subsidiaries are subject to various regulatory restrictions and at December 29, 2006, $664 million, representing 90% of the insurance subsidiaries' net assets, was available, but subject to regulatory approval, for distribution to Merrill Lynch.

### Other

Approximately 60 other subsidiaries are subject to regulatory and other requirements of the jurisdictions in which they operate.

With the exception of regulatory restrictions on subsidiaries' abilities to pay dividends, there are no restrictions on ML & Co.'s present ability to pay dividends on common stock, other than ML & Co.'s obligation to make payments on its preferred stock and trust preferred securities, and the governing provisions of the Delaware General Corporation Law.

## NOTE 17 Subsequent Events

During the third quarter of 2006, Merrill Lynch announced an agreement to acquire the First Franklin mortgage origination franchise and related servicing platform from National City Corporation for $1.3 billion. First Franklin originates non-prime residential mortgage loans through a wholesale network. The First Franklin acquisition was completed at the beginning of the fiscal first quarter of 2007. The results of operations of First Franklin will be included in our GMI segment.

On January 29, 2007, Merrill Lynch announced that it had entered into a definitive agreement with First Republic to acquire all of the outstanding common shares of First Republic in exchange for a combination of cash and stock for a total transaction value of $1.8 billion. First Republic is a private banking and wealth management firm focused on high-net-worth individuals and their businesses. The transaction is expected to close in or about the third quarter of 2007, pending necessary regulatory and shareholder approvals. Following the closing, the results of operations of First Republic will be included in our GWM segment.

**EXHIBIT 99.2**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of Merrill Lynch & Co., Inc.:

We have audited the consolidated financial statements of Merrill Lynch & Co., Inc. and subsidiaries ("Merrill Lynch") as of December 29, 2006 and December 30, 2005, and for each of the three years in the period ended December 29, 2006, management's assessment of the effectiveness of Merrill Lynch's internal control over financial reporting as of December 29, 2006, and the effectiveness of Merrill Lynch's internal control over financial reporting as of December 29, 2006, and have issued our reports thereon dated February 26, 2007 (which reports express unqualified opinions and include an explanatory paragraph regarding the change in accounting method in 2006 for share-based payments to conform to Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), *Share-Based Payment*). Such consolidated financial statements and our reports are included in this Annual Report on Form 10-K.

We have also previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Merrill Lynch as of December 31, 2004, the restated consolidated balance sheets of Merrill Lynch as of December 26, 2003 and December 27, 2002, and the related restated consolidated statements of earnings, changes in stockholders' equity, comprehensive income, and cash flows for the year ended December 26, 2003 and December 27, 2002 (none of which are presented herein); and we expressed unqualified opinions on those consolidated financial statements. (Our report on these financial statements included explanatory paragraphs for the change in accounting method in 2002 for goodwill amortization to conform to SFAS No. 142, *Goodwill and Other Intangible Assets*, for the change in accounting method in 2004 for stock-based compensation to conform to SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation — Transition and Disclosure*, by retroactively restating its 2003 and 2002 consolidated financial statements, and for the restatement to correct the accounting for certain retail account fees.)

In our opinion, the information set forth in Exhibit 12 under the captions "Ratio of Earnings to Fixed Charges" and "Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends" for each of the five years in the period ended December 29, 2006, included in this 2006 Annual Report on Form 10-K, is fairly stated, in all material respects, in relation to the consolidated financial statements from which it has been derived.

/s/ Deloitte & Touche LLP

New York, New York
February 26, 2007

**EXHIBIT 99.3**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of Merrill Lynch & Co., Inc.:

We have audited the consolidated financial statements of Merrill Lynch & Co., Inc. and subsidiaries ("Merrill Lynch") as of December 29, 2006 and December 30, 2005, and for each of the three years in the period ended December 29, 2006, management's assessment of the effectiveness of Merrill Lynch's internal control over financial reporting as of December 29, 2006, and the effectiveness of Merrill Lynch's internal control over financial reporting as of December 29, 2006, and have issued our reports thereon dated February 26, 2007 (which reports express unqualified opinions and include an explanatory paragraph regarding the change in accounting method in 2006 for share-based payments to conform to Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), *Share-Based Payment*). Such consolidated financial statements and our reports are included in this Annual Report on Form 10-K.

We have also previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Merrill Lynch as of December 31, 2004, the restated consolidated balance sheets of Merrill Lynch as of December 26, 2003 and December 27, 2002, and the related restated consolidated statements of earnings, changes in stockholders' equity, comprehensive income, and cash flows for the year ended December 26, 2003 and December 27, 2002 (none of which are presented herein); and we expressed unqualified opinions on those consolidated financial statements. (Our report on these financial statements included explanatory paragraphs for the change in accounting method in 2002 for goodwill amortization to conform to SFAS No. 142, *Goodwill and Other Intangible Assets*, for the change in accounting method in 2004 for stock-based compensation to conform to SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation — Transition and Disclosure*, by retroactively restating its 2003 and 2002 consolidated financial statements, and for the restatement to correct the accounting for certain retail account fees.)

In our opinion, the information set forth in the "Selected Financial Data" table under the captions "Results of Operations," "Financial Position" and "Common Share Data," for each of the five years included in this 2006 Annual Report on Form 10-K, is fairly stated, in all material respects, in relation to the consolidated financial statements from which it has been derived.

/s/ Deloitte & Touche LLP

New York, New York
February 26, 2007